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This paper is one in a series of briefing papers by the International Institute for Sustainable Development. Each of the papers focuses on an issue of particular importance for sustainable development in the South in the WTO's current round of negotiations—the so-called Doha Development Agenda. The aim of the series is to set out, in brief and uncomplicated style, what is at stake in those negotiations for those concerned with international development and the environment. The full set of papers, and more information about IISD's work on trade and sustainable development, can be accessed on IISD's Web site at http://www.iisd.org/trade.

Prepared by IISD for the Swiss Agency for Development and Cooperation (SDC)

Investment, Environment and Development

1. What is the issue?

The stakes in any international investment agreement are high, since every economy depends on investment. The natural environment is also a key stakeholder; only through investment will it be possible for countries to move from less sustainable to more sustainable economic foundations.

From the perspective of development, the particular prospect of World Trade Organization (WTO) negotiations on investment presents risks as well as opportunities. Many developing countries depend on foreign investment to augment an inadequate domestic stock of capital. At the same time, foreign investors may exert undue influence on these countries or may not contribute adequately to their domestic development priorities.

The WTO's Doha Ministerial Declaration opens the door to comprehensive negotiations on a multilateral investment agreement as part of the *single undertaking*. In other words, if investment negotiations are formally launched at the next Ministerial meeting in September 2003—a possibility that is by no means certain—then *nothing that is on the negotiating agenda can be agreed unless there is also agreement on investment*. Yet investment agreements have become increasingly controversial in developing countries, whose interests in such agreements vary widely, depending largely on their existing ability to attract foreign direct investment (FDI).

2. Background

A large number of bilateral investment agreements (BITs) have been concluded, mostly between developed and developing countries. It seems only natural to supplement (or even replace) these by a multilateral investment agreement. Such an agreement appears especially attractive to smaller countries with a large amount of outward foreign investment, since they are less likely than large countries to be able to protect the interests of their investors.

The Uruguay Round set out some initial markers for an investment agreement in the WTO through the Agreement on Trade Related Investment Measures (TRIMS), and the investment provisions of the General Agreement on Trade in Services (GATS). Following the Uruguay Round, negotiations were launched within the OECD for a Multilateral Agreement on Investment (MAI). The MAI was modelled on the investment provisions of the North American Free Trade Agreement (NAFTA), at that time the most recent and most highly-developed multilateral investment agreement.

The MAI included provisions designed to ensure non-discrimination (most favoured nation treatment and national treatment), prohibitions against certain "performance requirements," rules on minimum international standards of treatment and expropriation, and an investor-state dispute settlement procedure that utilized existing commercial arbitration institutions (ICSID and UNCITRAL). The MAI attracted unexpected attention, triggered by environmental concerns. As public unease increased, so did the realization among negotiators that the stakes were higher than anticipated. The number of exceptions grew very large. The MAI negotiations were abandoned when France withdrew, largely because of its desire to shield its cultural institutions.

All the above agreements and processes focused on the rights of the foreign investor and the obligations of the host state. There have also been attempts to develop international agreement on the obligations of foreign investors, but these have not been linked to the investment agreements in a binding way. The UN Centre on Transnational Corporations spent several years negotiating a code for transnational corporations but had to abandon the effort in light of unremitting opposition from developed country enterprises. The OECD has a set of Guidelines for Multinational Enterprises that were recently revised, but their adoption is voluntary.[1]

3. The current state of play

Since the collapse of the MAI negotiations there has been some uncertainty just how to proceed, with most advocates of a multilateral agreement assuming that the WTO is the appropriate forum for negotiations on investment. A final decision to proceed with WTO negotiations on investment will be taken at the WTO's Fifth Ministerial Conference in

September 2003. Strong resistance to such negotiations has come from a small group of developing countries.

It remains unclear what a WTO agreement on investment would look like. Working this out is the primary task of the Working Group on the Relationship Between Trade and Investment. Issues for the Working Group to consider include:

- the definition of an investment and an investor—the Doha text speaks of "long term" investments, implicitly excluding the portfolio investment that would have been covered by the MAI, but this issue has not yet been finally settled;
- transparency of government activity and minimum standards of treatment for foreign investors;
- non-discrimination;
- market access for investment;
- special provisions for developing countries;
- exceptions and balance-of-payments safeguards;
- consultation and the settlement of disputes between Members.

This listing appears to exclude some of the more controversial elements of the NAFTA/MAI approach, most notably the inclusion of portfolio investment and the investor-state dispute settlement process. Yet there is no guarantee that the process of negotiation will not lead right back into the quagmires of the MAI and NAFTA.[2] For example, one would anticipate rules on expropriation to be included, as they are in almost all other investment agreements, even though this is not expressly stated. It is widely assumed that the lessons from the MAI failure and the ongoing NAFTA controversies will be learned—but what the lessons are still depends on whom you talk to.

4. What is at stake: Sustainable development and investment agreements

There has not been much public discussion about the purposes of an investment agreement. It is assumed that a non-discriminatory regime will lead to the better allocation of scarce capital and that a reduction of political risks will permit investment at lower rates of return. But there is little empirical evidence that the existing investment agreements have made any difference in this respect, let alone promoted more efficient use of capital. The available evidence supports the prohibition of performance requirements as economically inefficient instruments, but not much more,[3] and recent World Bank analysis concludes that the myriad existing bilateral treaties "do not seem to have increased flows of investment to signatory developing countries."[4]

Yet the consequences of an effective investment agreement are potentially enormous. They differ dramatically between developed and developing countries. An international agreement must interact with domestic institutions to balance investor rights (rights of entry, rights to non-discriminatory treatment, etc.) against public goods (environmental integrity, health, etc.). In most developed countries these domestic institutions involve highly-developed procedures for the administrative review of projects and for regulatory or policy decisions impacting investments, followed by several layers of judicial review in cases of disputes. If an international regime is to involve itself in these complex and sensitive matters, it will require more sophisticated international institutions than have been contained in most investment agreements. In developing countries the task is less to avoid conflicts with existing institutions as to *develop* the institutional capability to properly assess, regulate and work constructively with investment projects in light of the public interest and the protected private rights. Ideally an international agreement should promote the development of this sort of domestic capability, not pre-empt it.

It is far from the conventional approach to think of investment agreements that actually confer obligations on investors as well as rights, and completely novel to search for ways that such agreements might build up the host country's capacity to manage investment. But against the background of the unsatisfactory performance of current agreements, such lines of enquiry look reasonable, if not necessary. If international investment agreements are to actually foster sustainable development, it is an approach that must be contemplated, in fora such as the WTO, as well as in new bilateral and regional agreements.

Endnotes

1 See Organization for Economic Cooperation and Development (OECD), The Guidelines for Multinational Enterprises. Paris: OECD, 2000. Available at http://www.oecd.org.

2 For an overview of the flaws in the functioning of NAFTA's Chapter 11, see Howard Mann, *Private Rights, Public Problems: A guide to NAFTA's controversial chapter on investor rights*. (Winnipeg): International Institute for Sustainable Development, 2001. (http://www.iisd.org/trade/private_rights.htm).

3 Theodore H. Moran. "The Relationship between Trade, Foreign Direct Investment and Development: New Evidence, Strategy and Tactics under the Doha Development Agenda Negotiations." Paper prepared for the Asian Development Bank's Study on Regional Integration and Trade: Emerging Policy Issues for Selected Developing Member Countries, 2002.

4 "2003 Global Economic Prospects and the Developing Countries Report," The World Bank, 2002, p. 118.

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